



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 334

First Amendment to the Third Rehabilitation Grant Agreement with the NTC Foundation

OVERVIEW

On Tuesday, September 27 the City Council will be requested to approve the First Amendment to the Third Rehabilitation Grant Agreement with the NTC Foundation ("First Amendment"). The First Amendment will provide additional grant funding in an amount not to exceed \$800,000 to support the Foundation's Phase II development plan. The need for additional grant funds was precipitated by a recent City Attorney opinion that prevailing wages are required to be paid for work performed on all eight of the buildings to be rehabilitated under the Phase II development plan. It was originally anticipated that prevailing wages would only need to be paid on the rehabilitation of three buildings that were funded by the Agency grant under the Third Grant Agreement. Staff is proposing that a refund of property tax payments made by the Agency on behalf of the Foundation in early 2011 be used as the funding source for this additional grant.

FISCAL/POLICY DISCUSSION

In September 2010, the Redevelopment Agency Board approved the Third Rehabilitation Grant Agreement with the NTC Foundation, which provided \$4 million in Agency funds to support the Foundation's Phase II development plan. Under the Phase II development plan, Agency funding is being leveraged as part of a larger financing package that would include Historic Tax Credits and New Market Tax Credits, among other funding sources. The Phase II development plan includes the rehabilitation of eight buildings within the Civic, Arts and Cultural Center (CACC) in the Naval Training Center Historic Core. Agency funding was designated for the rehabilitation of three buildings, while the leveraged funding sources would be used to rehabilitate the remaining five buildings.

When the budget for the Phase II development was originally prepared, it was anticipated that prevailing wages would be paid only on the rehabilitation of the three buildings funded by

Agency grant funds. Recently, however, a concern was raised by Agency special counsel regarding the application of prevailing wages with respect to all Phase II development. Redevelopment staff requested that the City Attorney's Office research the issue, and in August was advised that prevailing wages would be required for the rehabilitation of all eight buildings under the Phase II development plan. This additional expense resulted in a funding gap of nearly \$1 million. To partially mitigate this funding gap, staff is recommending an amendment to the Third Grant Agreement to provide additional funding in an amount not to exceed \$800,000. The remaining gap is expected to be mitigated with additional Historic Tax Credit funds, Foundation equity, and a reduction in the budget for tenant improvements.

As a separate matter, in February 2011, the Agency Board approved the payment of \$1.25 million in property taxes on behalf of the Foundation, including penalties and interest, related to seven buildings that were rehabilitated under the Foundation's Phase I development plan. As described in the staff report (RTC-11-117), the Foundation was required to establish for-profit subsidiaries in order to obtain tax credit funding as part of the Phase I financing package. Despite the fact that the Foundation is a non-profit entity, the San Diego County Tax Assessor determined that property taxes were due and payable on the seven buildings rehabilitated under Phase I due to the for-profit nature of the subsidiaries.

In response, the Foundation filed a property tax appeal with the County Assessor's office, and in July was notified that the properties would be taxed at a lower rate retroactively. As a result, the County will issue a partial refund of the property taxes paid by the Agency. While the total amount of the refund is presently unknown, it is not anticipated to exceed \$800,000. Staff is recommending that this refund (in an amount not to exceed \$800,000) be provided to the Foundation as an additional grant under the proposed First Amendment in order to partially mitigate the funding gap resulting from the required payment of prevailing wages.

Overall, the IBA supports the additional grant funding that is proposed under the First Amendment. Initially, our office had concerns with the request for additional funding, particularly following the action taken by the Agency in February to pay property taxes on behalf of the Foundation. However, after speaking extensively with Redevelopment staff and reviewing the matter further, we now view these issues as two unrelated, though unfortunate, set of circumstances. In addition, there are several issues that should be highlighted. First, it should be noted that because the property tax payments by the Agency were made from NTC tax increment funds, any refund will likewise be considered tax increment funds to be used for reinvestment back into the project area. In addition, the Assignment Agreements approved in March 2011 pursuant to the transfer of property and assets from Agency to the City specify that any proceeds or revenues generated by such properties or assets shall be used exclusively for redevelopment purposes within the respective project areas. The City Attorney's Office has confirmed that this requirement applies to the property tax refund from the County.

Secondly, staff has indicated that the Foundation is already bringing in as much revenue as possible through donations and other fundraising efforts, and therefore does not have the ability to raise the needed gap funding on its own. As discussed in previous Agency reports, the downturn of the economy has severely impacted the Foundation's ability to secure major donations. As a result, another funding source must be identified to bridge the funding gap.

Finally, and most significantly, the Foundation will not be eligible to receive New Market Tax Credits unless all other funding sources are in place, including any funding needed to close the gap resulting from the payment of prevailing wages. As previously mentioned, the Agency's \$4 million grant under the Third Grant Agreement is being leveraged as part of a much larger financing package. The table below reflects the different funding sources that are currently anticipated to fund the Phase II development plan, including the additional grant funding proposed under the First Amendment to the Third Grant Agreement.

Proposed Phase II Funding Package, in millions

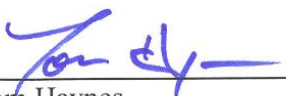
Funding Source	Amount
3rd Rehabilitation Grant (RDA)	\$ 4.0
3rd Rehabilitation Grant 1st Amendment	0.7
2nd Rehabilitation Grant Carryforward	1.7
New Markets Tax Credits	7.5
Historic Tax Credits	3.2
Conventional Loan	2.8
CA Cultural & Historic Endowment Grant	0.3
<i>Less: Loan Fees</i>	<i>(0.1)</i>
Total Funding	\$ 20.1

As shown, the New Markets Tax Credits account for a significant portion of the overall financing package. However, if the Foundation is unable to secure the New Market Tax Credits, staff has indicated that the entire \$20 million package would unravel, as each of the funding sources is contingent upon all other funding sources being secured. If this were to occur, it would jeopardize the Phase II development plan and may have additional ramifications for the broader NTC redevelopment project. Staff has also indicated that the deadline for closing the New Markets Tax Credit transaction is October 1. As such, it is critical that gap funding be secured as soon as possible.

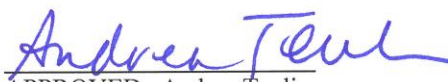
CONCLUSION

The proposed First Amendment to the Third Rehabilitation Grant Agreement would provide additional funding not to exceed \$800,000 to support the NTC Foundation's Phase II development of the Civic, Arts and Cultural Center (CACC) in the Naval Training Center Historic Core. This additional funding would partially mitigate a gap in the development budget resulting from a recent opinion by the City Attorney's Office with regard to the application of prevailing wages. Staff is recommending that a refund of property tax payments made by the Agency on behalf of the Foundation related to buildings rehabilitated as part of the Phase I development be used as the funding source for the additional grant under the First Amendment.

Overall, the IBA supports the staff recommendation and the additional grant under the proposed First Amendment. The property tax refund that is proposed to be used as the funding source for the additional grant are tax increment funds that must be used for redevelopment purposes within the NTC project area. In addition, staff has indicated that the Foundation is unable to raise the necessary funding through donations or other fundraising efforts, largely due to continued weakness in economic conditions. Finally, and most significantly, if all funding sources are not in place by October 1, the Foundation will fail to secure the New Markets Tax Credits, which will cause the entire \$20 million financing package to unravel and jeopardize the Phase II development plan.



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